

VZCZCXRO6821
PP RUEHPOD
DE RUEHVB #0522/01 2401050
ZNR UUUUU ZZH
P 281050Z AUG 09 ZDS
FM AMEMBASSY ZAGREB
TO RUEHC/SECSTATE WASHDC PRIORITY 9484
INFO RUEHBW/AMEMBASSY BELGRADE 0048
RUEHLJ/AMEMBASSY LJUBLJANA 6461
RUEHPOD/AMEMBASSY PODGORICA
RUEHPS/AMEMBASSY PRISTINA 0615
RUEHVJ/AMEMBASSY SARAJEVO 0329
RUEHTI/AMEMBASSY TIRANA 0856
RUEHBS/USEU BRUSSELS

UNCLAS SECTION 01 OF 02 ZAGREB 000522

C O R R E C T E D C O P Y (ADDED CAPTION)

SENSITIVE
SIPDIS

TO EUR DAS STU JONES FROM CDA VIVIAN WALKER

E.O. 12958: N/A

TAGS: [PREL](#) [ECON](#) [HR](#) [SI](#)

SUBJECT: SCENESETTER FOR EUR DAS JONES' VISIT TO ZAGREB

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¶1. (SBU) Summary. Your visit to Zagreb comes at a time of renewed optimism on the Slovenia border dispute, but also political and economic uncertainty for the young Kosor government. As the vacation season winds down, Croatian government leaders return to Zagreb with major challenges looming before them. If Kosor's team can successfully agree on a way forward with the Slovenes that allows Croatia's EU accession negotiations to re-start, perhaps even as early as mid-September, it would be a major accomplishment. A decisive factor in achieving this success, however, will be whether Ljubljana will truly be willing to lift its blockade on 14 accession chapters even in advance of a final agreement on arbitration arrangements for the border. Kosor's government will also face an economic crisis that now affects the average Croatian in a way that presents the potential for real political unrest this fall. Prime Minister Kosor's handling of these problems will do much to determine the longevity of her government. But she has the advantage of low expectations. Should she successfully break the border impasse, and simultaneously perform the difficult political dance of solidifying the budget, she will have scored major victories in two areas that her predecessor, for all his political skills, could not manage to tackle. Her HDZ party would then be on much sounder footing as Croatia approaches presidential elections in December. End Summary.

¶2. (SBU) Prime Minister Kosor's less combative approach with Ljubljana contributed to the better than expected meeting with Prime Minister Pahor on July 31, and the subsequent weeks of "silent diplomacy" at the senior advisor level. The Croatians and Slovenians now appear to be working in good faith to finalize the text of the first part of the Kosor-Pahor framework - the letter affirming that no documents produced since June 1991 should have any impact in prejudging the dispute nor relevance to any potential arbitration, and stating that the parties are ready to continue discussions on an arbitration process for the border based on the previous talks hosted by EU Commissioner Rehn and the EU Troika. We've been told both sides are close to agreement on this issue. Immediately after that, Croatia will expect Slovenia to ante up and remove their blockade of negotiations. An optimistic date for a new Intergovernmental Conference (i.e., round of accession talks) would be September 16. We believe October is a more realistic timeframe.

¶3. (SBU) The positive mood created by a re-start of EU accession talks would then set the stage for a serious return to talks on an Arbitration Agreement. Croatia would drop its insistence that the April document it accepted was "take it or leave it", and acknowledge that further modifications are possible. Our talks with

Kosor's foreign policy advisor indicate that Zagreb now believes the two sides are not that far apart, which is a significant change of mood since the beginning of the summer. Croatia may be prepared to accept something based on Rehn's June draft. But key issues for discussion will be: i) inclusion of some sort of "neutrality" language that makes clear it is not predetermined whether or not Slovenia will have direct contact with international waters, and ii) discussion of the timing of the award, where Croatia believes it would be in both sides' interest to have the binding arbitration decision issued only after Croatia's EU accession process is complete. It is important to note, however, that the Croatians are not yet ready to discuss specific changes to Rehn with Slovenia now - their focus is on getting Slovenia to lift its blockade on the accession negotiations, so that specific talks on the arbitration process can then re-commence.

14. (SBU) On economic questions, Prime Minister Kosor earned no credit from Croatians for her efforts earlier this summer to shore up the economy and the state budget. The rapid series of budget negotiations, and re-renegotiations, did little to resolve the thorny issues plaguing the economy. The major result of the several rounds of negotiations was increased taxes, both income and VAT. The only important spending cut was a decision to end free textbooks, pushing the expense of buying the texts onto parents. These measures only served to convince many Croatians of the government's unwillingness, or incompetence, to make difficult choices, and that the burden of covering the budget gap would fall on the general public, rather than any vested interests or privileged groups. Unions are now gearing up for nationwide strikes to begin the week of September 7, protesting (somewhat paradoxically) both the government austerity measures and the higher taxes. If the government continues to fail to form a realistic budget, Kosor will take fire from all sides. Even worse, she would probably face the prospect of going, hat in hand, to the IMF for assistance. This would sound a death knell for the HDZ government and make it very difficult to avoid early elections.

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15. (SBU) Undoubtedly Ms. Kosor is hoping to discover opportunity in crisis. If she could take credit for an unblocked EU process, she would instantly bank significant political capital that she could bring to the economic negotiating table. This would certainly help her in the monumental task of mollifying, cajoling, threatening, and dealing with the long line of farmers, pensioners, industries, and unions who were made lavish financial promises over the years, and which the government simply can no longer live up to. An IMF \$471 line-of-credit that has been all but delivered may give Kosor some extra breathing room in dealing with these groups, but tough choices and some level of unrest from some special interest groups are unavoidable.

16. (SBU) Regarding your schedule, your meeting with Foreign Minister Jandrokovic will be a good opportunity to discuss relations with Slovenia, hear his read-out of his meetings in Bled, and prognosis for the coming weeks. He will be pleased to hear of our continuing support for the effort to re-start Croatia's accession process. In particular we should praise both sides' discipline in pursuing "silent" diplomacy, emphasize that an early re-start to accession talks would be a fantastic confidence-builder, and note our belief that they should be able to find common ground on an Arbitration Agreement as long as both sides are genuinely willing to agree to a process that leaves it up to the arbitrators to determine whether or not any sort of direct contact between Slovenia and international waters is justified. With the President's foreign policy advisor, we should also express our hope that President Mesic will be supportive of the government's engagement with Ljubljana. Both the FM and foreign policy advisor will also likely be interested in hearing the latest on our views regarding Croatia's other neighbors, and particularly Bosnia.

17. (SBU) Your other scheduled events, at the National Bank and over lunch with a mixture of local economic experts and businesspeople, will provide a chance to hear first-hand their forecasts of how the next several months will go for Croatia's economy. A specific topic of interest will be their views on whether or not Croatia will need

to go to the IMF for assistance this fall.

WALKER